

## JEFFERSON COUNTY COMMISSION



DAVID CARRINGTON - PRESIDENT  
GEORGE F. BOWMAN  
SANDRA LITTLE BROWN - PRESIDENT PRO TEMPORE  
T. JOE KNIGHT  
JAMES A. "JIMMIE" STEPHENS

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CHAIR ADMINISTRATIVE SERVICES

DISTRICT 5

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To: Honorable Members of the Jefferson County Legislative Delegation

From: David Carrington

Date: September 30, 2011

I mailed a letter to you yesterday that detailed the reasons why I supported the sewer debt settlement framework.

Since that letter was sent, I have received updated information on the State's projected borrowing costs. As such, the second paragraph on Page 4 has been revised to say: The fifth reason I supported the negotiated settlement is the Chapter 9 borrowing cost financial impact on Jefferson County's cities, as well as on the state and other counties and cities in the state. Without a settlement, the State's Finance Department has estimated that the borrowing costs throughout the state could increase by as much as \$200 million over the next four years. Instead of paying higher interest rates, this money could be invested in economic development, infrastructure, education or lower taxes.

In addition, there is a minor change to the census age range on Page 2.

Attached is an updated letter for your review and consideration.

cc. Jefferson County Commissioners

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To: Honorable Members of the Jefferson County Legislative Delegation

From: David Carrington

Date: September 30, 2011

On September 16, 2011, the Jefferson County Commission voted to approve a negotiated sewer debt settlement term sheet that will now be used as the framework for a definitive settlement agreement.

Other than questions about the terms of the settlement (which I've provided in Attachment 1 for your review), my most frequently asked question is, "Why do you feel that the negotiated settlement is better for the residents of Jefferson County than declaring Chapter 9 bankruptcy?" It's a good question that deserves a candid answer. (Attachment 2 is a Birmingham News editorial I wrote several weeks ago that discusses the pros and cons of Chapter 9 bankruptcy.)

The first reason I supported the negotiated settlement is legal certainty if the settlement happens versus legal uncertainty – and risk -- if the County files Chapter 9. Chapter 9 will result in an ongoing series of legal issues that will need to be litigated and decided.

- One of the first matters that may be litigated is whether or not Jefferson County is eligible for Chapter 9 bankruptcy. I understand eligibility is contested in just about every Chapter 9 case; just recently, Boise County, Idaho's Chapter 9 petition was denied by the bankruptcy court.
- Shortly thereafter, if not concurrently, the powers of John Young, the sewer receiver, to control the sewer system and set rates will be litigated. Any litigation carries with it uncertainty. It bears remembering that Mr. Young was proceeding to implement a 25% sewer rate increase, just for starters, absent a settlement.
- Even though filing for Chapter 9 protection will result in an automatic stay of civil litigation against the County, the County can anticipate an ongoing series of hearings where petitioners will argue why their litigation against the County should proceed at least to judgment.
- Another matter that will be litigated is the dollar amount of the secured claim by the sewer warrant holders. We have every reason to expect that the warrant

holders and their representatives will argue for an amount far in excess of the amount to which the Commission has agreed to settle. There are no assurances that the rates that will come out of this process will not be higher than the rates outlined in this settlement. And, after the dollar amounts for all claims have been decided, the bankruptcy judge will be asked to confirm a plan prepared by the County that binds all of the County's creditors. The County's plan must be deemed by the bankruptcy judge to be appropriate and at least one class of creditors must consent to the plan.

Chapter 9 litigation may prove to be very costly, estimated at a minimum of \$1 million a month in outside legal and professional fees and lengthy (Vallejo's recently ended Chapter 9 lasted more than 3 years – from May 8, 2008 until confirmation of its plan of adjustment on July 28, 2011). And, no one knows for sure what the outcome will be. A final negotiated settlement would immediately put an end to a significant portion of the County's outside attorney fees and the \$500 per hour payments to the sewer receiver.

The second reason I supported the negotiated settlement is business certainty versus business uncertainty. Before relocating or expanding in a community, a business wants to understand their total cost structure, not just their sewer cost structure.

- Jefferson County needs jobs – and jobs come from businesses. It is worth noting that the Birmingham Business Alliance (BBA) supports the sewer settlement framework approved by the Commission. If the businesses in the BBA felt this settlement would adversely affect their total cost structure or economic growth, they would have told us so.
- There has been a lot of discussion about Jefferson County's sewer rates versus those of other cities and counties, particularly those that compete with Jefferson County for jobs. Based on Jefferson County's median residential sewer usage, several localities in Alabama and the Southeast have sewer rates that exceed the rates charged by Jefferson County, including Atlanta, Nashville, Cullman and North Shelby County.
- Declaring Chapter 9 bankruptcy will definitely hurt the County's quest for more jobs. One of the most disturbing statistics in the 2010 census is that while Jefferson County's overall population decreased 0.54% – essentially flat – the County's population in the key 35 - 44 age group declined 19.4%. If we don't want Jefferson County to become the "hole in the donut", we need to provide jobs for this key age demographic.

Economic development and job growth, not legal fees and expert witnesses, is the answer to many of the County's problems.

The third reason I supported the negotiated settlement is rate certainty versus rate uncertainty.

- Even though no one wants higher sewer rates, there is no guarantee that sewer rates will be lower in Chapter 9. As noted, if the sewer receiver prevails in his litigation, he has already announced an interim rate increase of 25%, for starters. The settlement provides for 3 years of sewer rate increases of no more than 8.2%. At the maximum rate increase of 8.2%, the median residential sewer bill of

\$37.74 would increase \$3.10 a month. These projections are conservative and the required rate increases could be lower based on interest rates and bond insurance.

- The settlement agreement recognizes that future increases will be required for operating expense increases and capital improvements. It is important to note that in order to keep the sewer system operational most of these "out-year" expenses would occur regardless of whether there is a settlement or a bankruptcy. Furthermore, while the term sheet estimates these increases will be no more than 3.25% annually, it should not be interpreted as meaning that these increases will be necessary every year for 40 years. Also, incomes will increase throughout the next 40 years, but with the settlement, our sewer debt payments will be fixed and known. To give you a benchmark, when Sonia and I got married in 1971, 40 years ago, the minimum wage was \$1.60 an hour; gas was 50 cents a gallon; our rent was \$105 a month; our college tuition was less than \$200 a semester; and we could go to the movies, buy popcorn and a coke, and go out to dinner for \$10. Our focus should be on the first three years of proposed sewer rate increases required to refinance the debt, not the operating increases that may or may not be required beginning in year 4.
- There will be a low income assistance program with the settlement, which could be paid for with creditor concessions or JP Morgan SEC funds. It has been widely reported, incorrectly, that 70% of all sewer revenues are paid by residents of District 1 and 2. This is wrong on two fronts. First of all, households only pay 37.4% of the total sewer revenues and the households in District 1 and 2 pay 49.0% of the residential sewer fees. As such, the households in District 1 and 2 pay 18.1% of the total sewer fees. (The residential accounts and sewer fees by district have been provided in Attachment 3 for your review.) The preceding facts are not meant to imply that there isn't a need for a low income assistance program to assist the poor with sewer rate increases. With that said though, if there isn't a settlement, there will be no money available for a low income assistance program for the sewer rate increases (which could be 25% in just the first six months if the sewer receiver gets his way), since there will be no creditor concessions and the JP Morgan SEC funds will need to be used for legal fees, expert witnesses and capital expenditures.

The fourth reason I supported the negotiated settlement is creditor concessions.

Jefferson County is receiving \$1.09 billion in creditor concessions (almost 35% of the total existing debt). In contrast, Orange County negotiated \$400 million in concessions on a total debt of \$1.6 billion (25%).

- The more than \$1 billion in settlement dollar concessions received by Jefferson County represents the highest municipal debt settlement in U.S. history.
- JP Morgan is offering total concessions of more than \$800 million, significantly more (in dollars and percentage) than the other financial institutions that were not involved in any of the sales or swaps.
- The settlement agreement protects the small, retail investors (otherwise known as the "mom and pops", some of whom live in Jefferson County) from any loss on their Jefferson County sewer bonds.

It is important at this point to note, that nothing in this settlement prevents the County from pursuing civil relief from parties that are not a part of this agreement. In addition, nothing the County does, with or without a settlement, can prevent ongoing criminal investigations and prosecutions.

The fifth reason I supported the negotiated settlement is the Chapter 9 borrowing cost financial impact on Jefferson County's cities, as well as on the state and other counties and cities in the state. Without a settlement, the State's Finance Department has estimated that the borrowing costs throughout the state could increase by as much as \$200 million over the next four years. Instead of paying higher interest rates, this money could be invested in economic development, infrastructure, education or lower taxes.

There are other reasons why I supported the negotiated settlement (all civil litigation against the County concerning these matters will be settled; the IRS audit concerning the taxability of the sewer bonds will be resolved; the interest rate swap fees will be terminated; etc.), but it is very important for all of us to realize that a settlement provides closure to our citizens sooner, rather than later; the sewer receiver's job will be eliminated; and our focus can be turned to restoring Jefferson County's economic engine.

In order for the negotiated settlement to work, we need your help. Without the passage of both general fund and sewer legislation, Jefferson County will have no choice but to file for Chapter 9. You have an opportunity to make a positive difference. Once it is all said and done, the citizens of Jefferson County and the State of Alabama will be better off because of your assistance.

If you want to discuss any of these points further, please don't hesitate to call.

cc: Jefferson County Commissioners

**Proposed Terms and Conditions for Settlement and Refinancing  
of Jefferson County's Outstanding Sewer Warrants**

**September 14, 2011**

**FOR SETTLEMENT PURPOSES ONLY; CONFIDENTIAL SETTLEMENT  
COMMUNICATION PROTECTED BY ALA. R.EVID. 408 and FED R. EVID. 408**

*The terms reflected herein are entirely contingent upon the negotiation and execution by all parties of a comprehensive settlement agreement and related documents, and satisfaction or waiver of all conditions contained in all fully negotiated agreements and documents.*

Jefferson County (the "County") and the participating holders of sewer warrants (the "Creditors") would agree to settle and refinance the County's outstanding sewer debt based upon the following general terms and conditions to be contained in comprehensive settlement documentation:

1. **Refinancing.** The parties are engaged in ongoing negotiations and anticipate a settlement in the approximate amount of \$2.05 billion to redeem all outstanding sewer warrants (contingent on an additional \$.03 billion in creditor concessions from Creditors to be identified in the future). Key provisions of refinancing debt to be issued by a newly formed public corporation (the "Refinancing") would include the following or other terms and conditions acceptable to the County and appropriate to effectuate the Refinancing:
  - (a) 40-year term.
  - (b) 1.25x debt service coverage.
  - (c) 10% Debt Service Reserve ("DSR"), half of which may be funded (at the County's option) by a surety bond provided by Assured Guaranty.
  - (d) Priority pledge of net sewer revenues.
  - (e) Moral obligation covenant by State of Alabama to seek legislative appropriations to replenish draws, if any, on the DSR.
  - (f) Up to \$1.0 billion of bond insurance (at the County's option) provided by Assured Guaranty.
  - (g) Issuance costs paid by County or GUSC (described in section 2 below).
  - (h) Closing: No later than June 30, 2012.
  - (i) Projected capital needs covered by existing warrant reserves and future cash flow.
2. **Creation of an independent public corporation for management and financing of the sewer system.** The County will seek, with the Governor's support, legislation in a

special session to authorize creation of a new form of governmental utility service corporation (GUSC) to serve as the issuer of the Refinancing debt and the operator of the sewer system.

- (a) Majority of GUSC directors to be appointed by Governor based on recommendations from the County; remainder to be appointed by County. All directors to possess appropriate professional credentials as specified in enabling legislation. County to appoint all GUSC directors after Refinancing bonds are satisfied, or refinanced without credit support from State.
  - (b) GUSC will be specifically authorized to file Chapter 9 with consent of the Governor. GUSC to covenant not to contest treatment of the pledged revenues as "special revenues" as defined in 11 U.S.C. section 902(2). Once the Refinancing bonds are paid or refinanced without credit support from the State, the GUSC will be eligible to file Chapter 9 without the Governor's consent.
  - (c) System to be transferred or otherwise conveyed to GUSC at close of Refinancing on terms assuring the County's right to return of the system assets upon satisfaction or payment of Refinancing debt. The GUSC shall be prohibited from selling, transferring, creating a lien on, or otherwise alienating the system assets without the prior approval of the County. Notwithstanding the foregoing, the system will only be transferred to the GUSC if such transfer is necessary to effectuate the Refinancing. If the Refinancing can be accomplished without such transfer, the County may determine whether or not to transfer the system assets to the GUSC.
  - (d) Receiver to remain in operating control of the sewer system until closing of the Refinancing pursuant to the Receiver order.
3. **Independent Consultants.** The Receiver's financing and operating models, including projections of capital expenditures and operating costs (upon which the County has relied in projecting future sewer rates and in creditor negotiations) may be verified by independent consultants retained by the County. Receiver to pay the reasonable costs thereof from sewer revenues.
4. **Rates.** It is anticipated that the Refinancing would require approximate rate increases of 8.2% for each of the first three years beginning November 1, 2011 (or as soon thereafter as possible), and future projected annual increases of no more than 3.25% for operating expenses and capital requirements until such time as the debt service requirements related to the Refinancing are met. The Receiver, acting pursuant to the terms of this term sheet, shall initiate the first rate increase immediately upon the County's approval of this term sheet (which shall occur no later than September 28, 2011). The first rate increase shall be consistent with the terms of this term sheet and the parties' overall settlement proposals.
5. **Environmental Services Department Overhead Charges.** All outstanding overhead charges of the County for services to the Environmental Services Department (ESD) shall

be paid within 30 days of execution of the binding settlement agreements.

6. **Low-Income Assistance Program.** The County shall establish and implement a low-income assistance program and/or a rate maintenance program. At its option, the County may allocate creditor concessions to fund either or both programs.
7. **Definitive Settlement Agreements.** The County, the Receiver, the State of Alabama and representatives of participating warrant holders and insurers will enter into definitive and binding settlement agreements to implement the terms contained herein and any other terms and conditions necessary to affect the Refinancing. The provisions of these agreements shall be acceptable to the County and the other parties and shall include, *inter alia*, the following terms and conditions to issuance of the Refinancing debt:
  - (a) Concessions and discounts on outstanding sewer warrants in an aggregate principal amount acceptable to the County as set forth in section 1 above.
  - (b) Enactment of legislation regarding:
    - i. GUSC formation and authorization, including mandatory sewer hookups for new construction within specified distance of existing sewer lines, and existing sewer customers.
    - ii. State moral obligation pledge.
    - iii. resolution of the General Fund deficiency issues
  - (c) Stay of all civil sewer-related litigation between and among the County and the Creditors pending close of Refinancing.
  - (d) Upon Refinancing and based on concessions from Creditors, dismissal with prejudice of all civil litigation and release of all claims involving, by, against and among the County and participating warrant holders related to the system, including but not limited to the *Wilson* litigation and any litigation involving the County, the monoline insurers and JPMorgan.
  - (e) Negotiation of closing agreement with the IRS covering existing sewer warrants and proposed Refinancing bonds, on terms satisfactory to the County and with no taxes, costs, or other liabilities to existing warrant holders.
  - (f) Judicial validation and confirmation of the Refinancing structure and proposed sewer rate model.
  - (g) To protect the County and the GUSC from market risk of the Refinancing, total annual debt service costs of the Refinancing will not exceed a predetermined debt schedule. The parties may consider additional concessions if market conditions change or interest costs rise.
  - (h) Delivery of County's audited financial statements through fiscal year 2010 by



October 31, 2011 and its fiscal year 2011 audited financial statements by January 31, 2012.

- (i) Parties will revert to status quo in the event the settlement agreement is terminated and/or the County files Chapter 9 bankruptcy prior to Refinancing.
  - (j) All interest rate swaps still outstanding shall be terminated at no cost to the County.
  - (k) All terms of the Refinancing shall be satisfactory to the County, the GUSC, and the State. The terms of the Refinancing shall also be satisfactory to the Receiver and the participating warrant holders but solely to the extent of the warrant holders' right to payment and any other rights of any specific warrant holders affected by and as provided in the settlement agreements.
8. **Series 2001-B General Obligation Warrants.** JPMorgan will (a) waive approximately \$9 million in claims arising from termination of a *pari passu* swap and accrued and unpaid default interest on such GO Warrants and (b) reinstate the original amortization schedule applicable to the GO Warrants.

Jefferson County, Alabama

By: \_\_\_\_\_  
President of the County Commission

  
Receiver

Jefferson City Environmental Services Dept.

## Some Straight Talk About Chapter 9

Chapter 9 is many things to many people. It is a powerful tool of last resort, but it is not a panacea. As such, it's time to set the record straight on what Chapter 9 can do and can't do for the citizens of Jefferson County.

Before the county can file for Chapter 9, it must be eligible to do so. Under the terms of the U.S. Bankruptcy Code, this involves negotiating in good faith with our creditors or showing why those negotiations are impractical. The county already has engaged in multiple negotiations with its creditors for quite some time now. The Commission recently directed Commissioner Stephens and me to engage in direct, face-to-face negotiations with individual creditors to make one last attempt to reach a negotiated settlement outside of Chapter 9. What can happen to the county and its creditors in Chapter 9 provides the backdrop against which these negotiations will be conducted.

Chapter 9 can provide the county protection against the commencement or continuation of law suits in different courts. A federal bankruptcy judge, appointed by 11th Circuit Chief Judge Joel Dubina, would preside over the case and would decide when and where litigation against the county would proceed or be settled.

This "litigation holiday" would give the county breathing space in which to negotiate and draft a plan to adjust its debts. Chapter 9 allows the bankruptcy judge to confirm a plan prepared by the county that binds all of the county's creditors. The county need not access the municipal bond market to refinance the debt adjusted under a plan but rather can replace that debt with new debt instruments. In fact, the bankruptcy judge can "cram-down" a plan on all dissenting classes (groups) of creditors, as long as the county's plan is deemed to be fair and equitable and at least one class of creditors consents to the plan.

Chapter 9 does not disrupt the county's dealing with its continuing vendors or employees. The county could relieve itself of burdensome contracts and more efficiently reorganize its operations. The bankruptcy judge may not interfere with governmental functions or impose new taxes or fees. In addition, the bankruptcy judge will not be able to set sewer rates, but will determine the dollar amount of the claim held by the sewer warrant holders. The amount of this allowed claim is uncertain and would be litigated or settled in the Chapter 9 case. Needless to say, any litigation carries risk.

To be clear, Chapter 9 does not operate as a printing press. It does not give the county the right to un-earmark funds or impose replacement revenues; this is a responsibility of the Alabama Legislature. Chapter 9 does not relieve the county from the balanced budget obligation imposed by the Alabama Constitution and it does not relieve the county from the environmental and personnel consent decrees.

In or out of Chapter 9 and no matter what happens with the sewer debt, the county's general fund deficit – created by the Supreme Court's ruling that the occupation tax was improperly advertised – is an ongoing problem and could very well push the county into bankruptcy. This year's general fund budget was \$312 million. Without relief from the Alabama Legislature, next

year's general fund budget will be approximately \$205 million – more than \$100 million less. This precipitous decrease in available funds will create a liquidity crisis and will result in further service reductions in county services, including but not limited to the sheriff's public safety budget, court system availability and security, road maintenance and construction, senior and community services, land planning and inspection services, and a probable delay in the collection and distribution of taxes to area cities and school systems.

Chapter 9 is very expensive. If the county has to file, the case could be very lengthy and cost the citizens of Jefferson County on average one million dollars a month in legal, accounting and consulting fees for expert witnesses. Even though time and cost factors make it imperative that the county do its best to negotiate a settlement with its creditors, the fees could pale in comparison to the savings Chapter 9 might bring to the county through permanent debt forgiveness and county restructuring.

Despite its limitations, Chapter 9 is a powerful tool. I have consistently said that Chapter 9 cannot be taken "off the table". It isn't something I want to do, but it is something I'm prepared to do if that is what it takes to find a permanent solution to the county's many financial and economic problems.

# Residential Sewer Revenue Analysis

Jurisdiction	# of R Accts <sup>1</sup>	% of R Accts <sup>1</sup>	% of R Revenue <sup>1</sup>	R Revenue as % of Total System Revenue <sup>1</sup>	District 1 <sup>2</sup>		District 2 <sup>2</sup>		District 3 <sup>2</sup>		District 4 <sup>2</sup>		District 5 <sup>2</sup>	
					% of R Accts	% of R Revenue	% of R Accts	% of R Revenue	% of R Accts	% of R Revenue	% of R Accts	% of R Revenue	% of R Accts	% of R Revenue
Birmingham	64,399	48.40%	44.70%	16.70%	21.59%	19.94%	21.40%	19.76%	4.11%	5.72%	0.71%	0.52%	4.08%	5.68%
Hoover	10,903	8.20%	11.40%	4.30%					1.07%	0.78%			5.16%	7.30%
County	2,366	1.80%	1.30%	0.50%							1.92%	1.94%		
Vestavia Hills	6,861	5.20%	7.30%	2.70%	0.25%	0.26%			0.00%	0.00%	1.90%	1.90%		
Center Point	2,889	2.20%	2.20%	0.80%										
Center Point	48	0.00%	0.00%	0.00%										
Adamsville	48	0.00%	0.00%	0.00%										
Clay-Chalkville	2,492	1.90%	1.90%	0.70%										
Fairfield	3,637	2.70%	2.60%	1.00%	2.70%	2.60%					0.04%	0.03%		
Fairfield	637	0.50%	0.40%	0.10%	0.44%	0.37%					0.90%	0.80%		
Fultondale	1,133	0.90%	0.80%	0.30%									4.60%	5.10%
Gardendale	6,144	4.60%	5.10%	1.90%									2.80%	5.90%
Homewood	3,686	2.80%	5.90%	2.20%										
Mountain Brook	272	0.20%	0.20%	0.10%					0.20%	0.20%		0.70%		
Pleasant Grove	932	0.70%	0.70%	0.20%							1.30%	1.10%		
Pinson	1,683	1.30%	1.10%	0.40%							0.00%	0.00%		
Tarrant City	26	0.00%	0.00%	0.00%										
Warrior	14,555	10.90%	8.70%	3.20%			7.12%	5.66%	3.82%	3.04%	1.50%	1.30%		
Bessemer	2,059	1.50%	1.30%	0.50%							4.00%	3.10%		
Irondale	5,287	4.00%	3.10%	1.20%										
Trussville	431	0.30%	0.20%	0.10%					0.30%	0.20%			1.90%	1.20%
Graysville	2,594	1.90%	1.20%	0.40%									18.54%	25.18%
Leeds	2,594	1.90%	1.20%	0.40%										
Total	133,033	100.00%	100.00%	37.40%	24.98%	23.16%	28.82%	25.84%	9.50%	9.94%	18.39%	16.40%		

R Accts = Residential Accounts

<sup>1</sup> Data provided by JeffCo Environmental Services Dept. (ESD)

<sup>2</sup> District allocations based upon voter registration data provided by the Board of Registrars